

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**

Author: Yee Analyst: Gail Hall Bill Number: SBX6 20
Related Bills: See Legislative History Telephone: 845-6111 Introduced Date: September 21, 2010
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Employer Tax Incentives/Reporting Information/New Incentives Enacted On or After January 1, 2011, Would Be Recaptured If Taxpayer Has Net Decrease In Full-Time Equivalent

SUMMARY

This bill would disallow certain business tax incentives that reduce tax if the taxpayer fails to achieve specified employment requirements.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to bring needed transparency and accountability to tax breaks given to taxpayers under Personal Income Tax Law (PITL) and Corporation Tax Law (CTL).

EFFECTIVE/OPERATIVE DATE

As a special session bill, this bill would be effective 91 days after the adjournment of the special session and it would be generally operative for taxable years beginning on or after January 1, 2011, and specifically operative for business tax incentives enacted on or after January 1, 2011. The calculation of the net decrease in full-time equivalent employees would be determined on or after January 1, 2014.

POSITION

Pending.

ANALYSIS**FEDERAL/STATE LAW**

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Board Position:	Department Director	Date
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Internal Revenue Code sections 267, 318, and 707 provide rules relating to the current year deductibility of losses, expenses, and interest with respect to transactions between related taxpayers, rules for determining the constructive ownership of stock, and rules governing transactions between partners and partnerships, respectively.

THIS BILL

This bill would require a taxpayer doing business in the state under the PITL or the CTL that claims a business tax incentive to annually submit to the Franchise Tax Board (FTB) on a timely filed original return the following information in the form and manner as required by forms and instructions prescribed by the FTB:

- The number of full-time, part-time, and temporary employees, as defined, employed by the taxpayer in the state for the current and preceding taxable years.

This bill would provide that for any business tax incentive that is allowed by an act that is enacted on or after January 1, 2011, if the taxpayer has a disqualifying event occur before the close of the recapture period, the business tax incentive would be subject to recapture.

- A disqualifying event would be defined as a net decrease (see the discussion on the calculation on page 3 of this analysis) in the average number of full time equivalent employees, calculated as of the last day of the current taxable year.
- Recapture period would mean the first full taxable year beginning after the close of the taxable year in which the business tax incentive reduces either the taxpayer's taxable income (PITL), net income (CTL), net tax (PITL), or tax (CTL), and the four succeeding taxable years.

"Business tax incentive" would mean a credit, deduction, exclusion, exemption, or any other tax benefit provided by the state that is added by an act that is enacted on or after January 1, 2011, and enacted with the purpose of creating new jobs in the state; and allowed to taxpayers engaged in or carrying on any trade, business, profession, vocation or calling, or commercial activity in the state.

The net decrease in full-time equivalent employees in the state would be determined on and after January 1, 2014, on a full-time equivalent basis as follows:

- The total number of full-time equivalent employees in the state employed in the three preceding taxable years by the taxpayer and by any trade or business acquired by the taxpayer during the current taxable year, divided by three, minus
- The total number of full-time equivalent employees in the state employed in the current taxable year by the taxpayer and by any trade or business acquired during the current taxable year.

Employees in the state who are employed in any trade or business sold by a taxpayer would be excluded in the determination of the net decrease in full-time equivalent employees.

This bill would define “full-time equivalent” to mean either of the following:

- In the case of a full-time employee paid hourly-qualified wages, the total number of hours worked for the taxpayer by the employee (not to exceed 2,000 hours per employee) divided by 2,000.
- In the case of a salaried full-time employee, the total number of weeks worked for the taxpayer by the employee divided by 52.

In addition, the bill would provide that all employees of trades or businesses treated as related under either sections 267, 318, or 707 of the Internal Revenue Code would be treated as employed by a single taxpayer.

This bill would provide the following definitions:

- “Full-time employee” would mean an employee who works an average of 35 hours in a week, calculated monthly.
- “Part-time employee” would mean an employee who works less than an average of 35 hours in a week, calculated monthly.
- “Temporary employee” would mean an employee who works less than 120 days per year.

Recapture Provisions

If there is a disqualifying event, the recaptured amount would be added to income or tax in the taxable year the disqualifying event occurs, including the interest amount.

The recapture amount would be computed by multiplying the total amount of the current taxable year’s business tax incentive and prior taxable years excluding the amounts previously recaptured, by a fraction, the numerator which is the net decrease in full-time equivalent employees and the denominator, which is the cumulative increase in the full-time equivalent employees calculated from the last day of the first taxable year the business tax incentive was claimed on the return to the last day of the taxable year immediately preceding the taxable year of the disqualifying event.

- If the denominator of the fraction equals zero or a negative amount, 100 percent of the business tax incentive would be subject to recapture.
- If the fraction is greater than one, not more than 100 percent of the business tax incentive could be subject to recapture.

The interest amount would be computed using the adjusted annual rate from the due date of the return for each taxable year in which the business tax incentive reduced a taxpayer’s income or tax to the date of the payment of the additional tax.

The amount of recapture computed would first be applied against the applicable business tax incentives that reduced income or tax for the earliest taxable year, and then to the succeeding taxable years. If there is any remaining recapture amount, the excess would be applied against remaining carryovers of the business tax incentives.

The recapture amount would be in addition to any other recapture amounts imposed under the PITL or the CTL.

Under PITL, this bill would not apply to a taxpayer with 25 or fewer employees and with net business income of less than \$500,000 for the taxable year. "Business income" would mean income from a trade or business, whether conducted by the taxpayer or a passthrough entity, owned directly or indirectly by the taxpayer. "Passthrough entity" would mean a partnership or S corporation, income from rental activity, and income attributable to a farming business.

Under the CTL, this bill would not apply to a taxpayer with 25 or fewer employees and with income subject to tax of less than \$500,000.

Assigned Business Tax Incentives (CTL Only)

This bill provides the following rules for business tax incentives that could be sold, assigned, or transferred (assigned):

- Any business tax incentive that is allowed to be assigned, would only be valid if the seller or assignor expressly agrees to provide the buyer or assignee and the FTB in the form and manner specified by the FTB, any necessary information to calculate whether a disqualifying event has occurred with respect to the seller or assignor.
- If a disqualifying event occurs, the buyer or assignor would be required to include in income or tax the amount of any required recapture.
- The assignment and recapture rules would apply to any business tax incentive that is assigned under the CTL.
- A notice of proposed deficiency assessment attributable to the business tax incentive to which the reporting requirements were not met could be mailed to the buyer or assignee within four years from the date on which the reporting requirements are met by the seller or assignor. The four-year period does not start until all of the information needed to satisfy the reporting requirements is provided.

This bill would not limit the authority of the FTB to audit the information provided by the taxpayer. In addition, this bill would waive review by the Office of Administrative Law any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the FTB relating to the information required to be submitted by a taxpayer relating to full-time, part-time, and temporary employees.

Penalties

The amount of the understatement of tax for the taxable year that is attributable to the disallowance or recapture of a business tax incentive would exclude from the calculation of any penalty under the PITL, CTL, and the Administration of Franchise and Income Tax Laws and Regulations.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

This bill does not have any revenue effect because it does not alter any provisions of current tax law.

This bill would place constraints on potential future changes to tax law. The effects of this bill would be incorporated into the revenue estimates for future proposals to add business tax incentives; but cannot be estimated now because we do not know what those future proposals will be.

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